

Give and take

UNDERSTANDING THE CONCEPT OF SUSTAINABILITY IN THE BUSINESS
SECTOR MEANS MORE THAN JUST 'DOING THE RIGHT THING'

BY JONATHON HANKS

In terms of the King III Report on Governance for South Africa, all companies listed on the JSE are required to issue an integrated report for financial years starting on or after 1 March 2010, or explain why they are not doing so.

While many large SA companies have been reporting on their sustainability performance for some time now (Sasol and Eskom have issued reports for more than 15 years), this new requirement reflects an understanding of societal issues that contrasts strongly with what has characterised much of the corporate response thus far.

For many in the corporate sector, sustainability is seen as a soft issue, far removed from the real business of maximising shareholder value. It's all too often seen as being about giving back to society through a social investment programme, encouraging marketing departments to

embrace the new 'green agenda', and signing up to charters and initiatives that supposedly signify some form of higher moral compass.

As Claire Jennings, technical manager at auditing and accounting firm PKF (Johannesburg), puts it: 'Many companies still see sustainability as being about corporate social investment and tree-hugging, it's absolutely not in their strategy.'

Rethinking value creation

This misunderstanding of sustainability demonstrates both a failure within the business sector to appreciate the strategic significance of societal issues, as well as the flawed approach of many within the sustainability movement who continue to frame the debate in the context of 'doing the right thing'.

Apropos the first of these weaknesses, respected business strategy guru, Michael Porter, suggests in a recent edition of the *Harvard Business Review* that the ‘big problem’ lies with companies who ‘remain trapped in an outdated approach to value creation’, in which their obsession with short-term financial performance ignores the broader societal influences that determine longer term success.

On the second of these challenges, the former executive director of Greenpeace, Paul Gilding, sums up the flaw in the approach that informs the corporate social responsibility (CSR) movement: ‘If you think about the language of CSR, it’s about focusing not only on profits, but on the “right thing to do”. As soon as you have that conversation you are effectively saying to the corporate world that this whole agenda is about things that you should do and are morally obligated to do, but not what you want to do or that are good for business. That mind-set, whatever you think of it morally, will fail in business.’

Integrated reporting – as envisaged in the discussion paper *Framework for Integrated Reporting and the Integrated Report*, which provides guidance to SA-listed companies and other organisations – seeks to address both of these challenges.

Recognising that there is only one bottom line in business, the paper explicitly adopts a value-based approach towards sustainability. In doing so it implies the death of the ‘triple bottom line’, while at the same time challenges the current ‘outdated approach to value creation’ that permeates most boardrooms across all levels.

The paper defines an integrated report as: ‘A report to stakeholders on the strategy, performance and activities of the organisation in a manner that allows stakeholders to assess the ability of the organisation as a whole to create and sustain value over the short, medium and long term.’

It suggests that an effective reporting process should foster an appreciation within the organisation and among its stakeholders of the extent to which the organisation’s ability to create and sustain value is based on financial, social, economic and environmental systems, and by the quality of its relationships with its stakeholders.

An underlying objective of the integrated report is to allow its users to determine ‘whether the organisation’s governing structure has applied its collective mind in identifying the environmental, social, economic and financial issues that have an impact on the organisation, and to assess the extent to which these issues have been incorporated into the organisation’s strategy’.

It is clear that an integrated report is not simply a case of combining the annual and sustainability reports into one document. Instead, the report should demonstrate how the organisation has reviewed its strategy in the context of societal issues. The question should no longer be ‘what is my sustainability programme in the context of my business strategy’, but rather ‘what is my business strategy in the context of sustainability challenges’.

Overcoming the ‘dead hand of compliance’

The recently established International Integrated Reporting Committee – a powerful cross-section of representative bodies from the corporate, investor, accounting, securities, regulatory and standard-setting sectors – argues that the financial crisis ‘was in part driven by individuals and organisations focusing on short-term profits irrespective of their long-term sustainability’.

The committee suggests that the crisis ‘has demonstrated the need for capital market decision-making to reflect long-term considerations and has called into question the extent to which corporate reporting disclosures, as they exist today, sufficiently highlight the systematic risks to business’.

There are various concerns with current corporate reporting practice that are prompting this shift to integrated reporting.

Most annual reports tend to be based largely on backward-looking financial information that fails to provide the insight necessary to assess a company’s ability to respond to the increasingly evident economic, social and environmental challenges.

These reports are often guilty of ‘carpet-bombing’ – covering too many non-material issues in the hope of meeting the needs of all its stakeholders (and in the process often failing to satisfy any of them). Importantly, these reports typically fail to make the link between societal issues and core strategy.

Underpinning these weaknesses within the report, are concerns about the process of reporting: these processes typically fail to build trust among the organisation’s stakeholders and they generally fail to inform the organisation’s strategy.

Accounting firm PricewaterhouseCoopers sums up these weaknesses in its suggestion, in one of its guidance documents on reporting, that ‘too many reports display the dead hands of compliance and the editorial committee; too few companies have cut through the historic clutter and the short-term financials to create a strategic picture of the business that is informative and convincing’.

Recent experience in SA boardrooms suggests that all too often this ‘dead hand of compliance’ – the hand of corporate lawyers and accountants – is not only a very dead hand indeed, but also a heavy hand that constrains the need to challenge the status quo and that undermines the drive for greater innovation.

Strategic opportunity or added burden?

In his introduction to the *Integrated Reporting Discussion Paper*, Mervyn King argues that: ‘If done properly, organisations that produce an integrated report for the first time will take a new look at themselves and their business models ... and will be encouraged to explore new and potentially innovative opportunities in their products, services, processes and markets.’ He maintains further that integrated reporting ‘has the ability to improve strategic decision making, improve performance and enhance reputation among stakeholders’.

It remains to be seen, however, whether integrated reporting will fully realise these potential benefits. For this to happen there needs to be an informed appreciation, both within the corporate sector and the accountancy profession, of the underlying purpose of integrated reporting.

PKF’s Jennings provides some cautionary observations on both counts. She maintains that in her experience most reporting companies are ‘somewhat overwhelmed’ by what they see to be yet another reporting requirement. ‘Frankly, many of them wonder what’s the point of doing this, arguing that “no-one really cares whether I am doing good for the environment”.’

Asked whether her colleagues in the accounting profession see any benefit from integrated reporting, Jennings says that ‘many of them see this as an added burden for companies; but also as a potential new money-spinner for accountants’.

Leigh Roberts, project director of Sustainability and Integrated Reporting at the South African Institute of Chartered Accountants, says that the reaction to the discussion paper has been largely positive with many players lauding SA’s role in furthering the international debate on integrated reporting. ‘It may well take a while for integrated reporting to become mainstream, but I’m sure companies will reap the benefits as they progress on their reporting journey.’

It’s clear that integrated reporting represents an important evolution in reporting practice. Maybe it will also prompt a revolution in the outdated approach to value creation. For this to happen, however, we will need to see a fundamental shift among those who wield, or succumb to, the dead hand of compliance. 🌱